



September 2015

DOD CONTRACT SERVICES

Improvements Made to Planning and Implementation of Fiscal Controls

Report Documentation Page				Form Approved OMB No. 0704-0188	
Public reporting burden for the collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington VA 22202-4302. Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to a penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number.					
1. REPORT DATE SEP 2015		2. REPORT TYPE		3. DATES COVERED 00-00-2015 to 00-00-2015	
4. TITLE AND SUBTITLE DOD Contract Services: Improvements Made to Planning and Implementation of Fiscal Controls				5a. CONTRACT NUMBER	
				5b. GRANT NUMBER	
				5c. PROGRAM ELEMENT NUMBER	
6. AUTHOR(S)				5d. PROJECT NUMBER	
				5e. TASK NUMBER	
				5f. WORK UNIT NUMBER	
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) U.S. Government Accountability Office, 441 G Street NW, Washington, DC, 20548				8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)				10. SPONSOR/MONITOR'S ACRONYM(S)	
				11. SPONSOR/MONITOR'S REPORT NUMBER(S)	
12. DISTRIBUTION/AVAILABILITY STATEMENT Approved for public release; distribution unlimited					
13. SUPPLEMENTARY NOTES					
14. ABSTRACT					
15. SUBJECT TERMS					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT Same as Report (SAR)	18. NUMBER OF PAGES 27	19a. NAME OF RESPONSIBLE PERSON
a REPORT unclassified	b ABSTRACT unclassified	c THIS PAGE unclassified			

GAO Highlights

Highlights of [GAO-15-780](#), a report to congressional committees

Why GAO Did This Study

Paying contractors for services, such as program management support, accounted for more than half of DOD's \$285 billion in total acquisition obligations for fiscal year 2014. Congress limited DOD's contract services obligations for fiscal years 2012 through 2014 and required funding reductions of 10 percent per year in 2012 and 2013 for contracts with closely associated with inherently governmental and staff augmentation functions. Subsequently, Congress extended the time period for DOD to achieve required funding reductions in select contract services through 2014. In December 2014, GAO reported on DOD's implementation for fiscal years 2012 and 2013 and made several recommendations to improve DOD's management of contract services.

The House Armed Services Committee Report 113-446 included a provision for GAO to review DOD's implementation of the contract services limits. This report addresses the extent to which, DOD implemented (1) the contract services spending limit for fiscal year 2014 and (2) funding reductions for closely associated with inherently governmental and staff augmentation functions from fiscal years 2010 through 2014. GAO reviewed relevant guidance; analyzed DOD financial, inventory, and other contract services data; and interviewed relevant officials.

What GAO Recommends

DOD has efforts underway to address GAO's December 2014 recommendations; therefore, GAO is not making any new recommendations in this report. DOD concurred with the findings of this report.

View [GAO-15-780](#). For more information, contact Marie A. Mak at (202) 512-4841 or MakM@gao.gov.

September 2015

DOD CONTRACT SERVICES

Improvements Made to Planning and Implementation of Fiscal Controls

What GAO Found

The Department of Defense (DOD) obligated \$54.6 billion, or \$280 million less than the limit on contract services for fiscal year 2014 due, in part, to increased oversight by the DOD Comptroller's office and military departments. The Comptroller's office sought input from components—military departments and defense agencies—when setting obligation targets and implemented a waiver request process to allow for adjustments, which it had not done in 2012 or 2013. The military departments also implemented a variety of controls over contract services obligations, but experienced varying degrees of success in adhering to their targets.

Actions to Manage Contract Services Obligations in Fiscal Year 2014

Military Department	Solicited commands' inputs ^a	Set command targets	Monitored obligations	Adhered to obligation target
Air Force	✓	✓	✓	✓
Army	✓	✓	✓	
Navy	✓		✓	

Source: GAO analysis of military department documents. | GAO-15-780

^aA command is an organizational sub-unit or organization of a military department or the defense agency.

Moreover, Army and Navy budget officials identified additional actions their departments' plan to take to improve adherence to the spending limit. For example, Army budget officials are soliciting contract services budget estimates from commands and the Navy has increased monitoring of contract services obligations from twice a year to monthly.

GAO analysis of DOD obligation data from fiscal years 2010 through 2014 indicate that all of the military departments achieved required funding reductions for contractors performing closely associated with inherently governmental and staff augmentation functions—positions that run the risk of contractors inappropriately influencing government decisions. DOD initiated a different approach in fiscal year 2015 to measure compliance after GAO found in December 2014 that DOD lacked the data necessary to demonstrate reductions and recommended that DOD identify additional data sources to ensure funding reductions were achieved. Congress facilitated DOD's implementation of this recommendation in the National Defense Authorization Act (NDAA) for fiscal year 2015, encouraging DOD to use advisory and assistance services—a budget category that includes many of the types of contract services that are considered closely associated with inherently governmental and staff augmentation—to measure compliance with funding reductions. DOD issued guidance in May 2015 adopting the alternative measure and instructed components to submit these data as part of the fiscal year 2017 budget request. Based on currently available obligation data through fiscal year 2014, GAO found that the Air Force and Navy achieved reductions greater than 20 percent as required by Congress from 2010 through 2013. The Army achieved a 9 percent reduction by 2013, but achieved a 32 percent reduction in 2014. The DOD Comptroller plans to assess compliance for all DOD components, including the military departments, after the submission of the fiscal year 2017 budget request, which is expected in February 2016.

Contents

Letter		1
	Background	3
	DOD Adhered to the 2014 Contract Services Spending Limit Due in Part to Increased Oversight from the Comptroller and Military Departments	8
	Military Departments Achieved Required Funding Reduction for Key Functions Based on Revised Approach to Measure Compliance	14
	Agency Comments	16
Appendix I	Objectives, Scope, and Methodology	19
Appendix II	Comments from the Department of Defense	21
Appendix III	GAO Contact and Staff Acknowledgments	22
Tables		
	Table 1: Military Department Actions to Manage Contract Services in Fiscal Year 2014	11
	Table 2: DOD Military Department Advisory and Assistance Obligation Reductions, Fiscal Years 2010-2014	15
Figure		
	Figure 1: Comparison of DOD and GAO Spending Limit Calculations for Fiscal Year 2014	9

Abbreviations

DOD	Department of Defense
FMC	Financial Management and Comptroller
NDAA	National Defense Authorization Act
PRCP	program resource collection process

This is a work of the U.S. government and is not subject to copyright protection in the United States. The published product may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.



September 30, 2015

Congressional Committees

The Department of Defense (DOD) is the federal government's largest purchaser of contractor provided services, relying on contractors to perform various functions, such as professional and management support, information technology support, and maintenance of military equipment. In fiscal year 2014, contract services constituted more than half of DOD's \$285 billion in total acquisition obligations. Our prior work has shown that there are benefits to using contractors to perform services for the government.¹ However, DOD acquisition of contract services continues to be an issue we identified as high risk, in part, because DOD lacks reliable data on its contract services acquisitions to inform decision making, such as the appropriate workforce mix between military, civilian, and contractor personnel.²

Citing the need to reduce DOD spending on services and to maintain the appropriate balance between the civilian and contractor workforce, section 808 of the National Defense Authorization Act (NDAA) for fiscal year 2012³, as modified by section 802 of the NDAA for fiscal year 2014⁴, imposed various limits on DOD's contracted services for fiscal years 2012 through 2014. Specifically, the NDAA set limits on DOD's total obligations for contract services and instructed the Secretary of Defense to issue guidance to reduce funding for contracts that have contractor staff performing services that are closely associated with inherently

¹GAO, *Defense Acquisitions: Continued Management Attention Needed to Enhance Use and Review of DOD's Inventory of Contracted Services*, [GAO-13-491](#) (Washington, D.C.: May 23, 2013).

²GAO, *High-Risk Series: An Update*, [GAO-15-290](#) (Washington, D.C.: Feb. 11, 2015).

³Pub. L. No. 112-81, § 808 (2011).

⁴Pub. L. No. 113-66, § 802 (2013).

governmental or staff augmentation functions.⁵ House Armed Services Committee Report 113-446 accompanying the NDAA for Fiscal Year 2015 contained a provision for GAO to review DOD's implementation of these limits and funding reductions.⁶ We previously reported on implementation for fiscal years 2012 and 2013 and made a number of recommendations to improve DOD's implementation of the contract services limitations.⁷ These recommendations and their status are discussed later in this report.

This report addresses DOD's progress to implement our previous recommendations and further implementation of the contract services limitations for fiscal year 2014. Specifically we assessed the extent to which DOD implemented the (1) contract services spending limit for fiscal year 2014 and (2) funding reductions for contracts with closely associated with inherently governmental and staff augmentation functions from fiscal years 2010 through 2014.

To identify implementation efforts for each objective, we reviewed relevant guidance and discussed implementation efforts with budget, acquisition, and manpower officials from the Office of the Under Secretary of Defense (Comptroller) and the military departments. Further, we analyzed DOD Comptroller budget and obligation data for fiscal years 2010 and 2014 to assess DOD's methodology for determining the annual spending limit and the extent to which DOD adhered to this mandated limit. We compared the Comptroller obligation data to services obligations reported in the Federal Procurement Data System-Next Generation and the military departments' financial systems to identify any differences. When differences were identified, we interviewed budget and financial management officials from the military departments and Comptroller's

⁵Closely associated with inherently governmental functions are those that while not inherently governmental, may approach the category because of the nature of the function, the manner in which the contractor performs the contract, or the manner in which the government administers performance under a contract. The FAR provides examples of such functions. FAR § 7.503(d). Staff augmentation contracts are defined as contracts for personnel that are subject to the direction of a government official other than the contracting officer, including but not limited to personnel services contractors. Pub. L. No. 112-81, § 808(d)(3) (2011).

⁶H.R. Rep. No. 113-446, at 178 - 179 (2014) (Comm. Rep.).

⁷GAO, *DOD Contract Services: Improved Planning and Implementation of Fiscal Controls Needed*, [GAO-15-115](#) (Washington, D.C.: Dec. 11, 2014).

office to determine the reasons for these differences. Based on these steps, we determined that the obligation data provided by the Comptroller's office were sufficiently reliable for our purposes. To identify steps taken by the DOD to implement fiscal controls, we limited our analysis to implementation efforts by the military departments, which account for over 70 percent of DOD's contract services obligations in fiscal year 2014. To determine the extent to which DOD implemented funding reductions for closely associated with inherently governmental and staff augmentation contracts, we reviewed DOD components' compliance with relevant DOD guidance. For example, in accordance with DOD's May 2015 guidance, we analyzed military department advisory and assistance services obligations from fiscal years 2010 through 2014 to determine reductions achieved over the time period. For more information on our scope and methodology, see appendix I.

We conducted this performance audit from January 2015 through September 2015 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Legislative Contract Services Limitation Requirements

Section 808 of the NDAA for fiscal year 2012, as amended by section 802 of the NDAA for fiscal year 2014, limited DOD's total obligations for contract services in fiscal years 2012 through 2014 to the amount requested for these services in the fiscal year 2010 President's Budget Request. The limit does not apply to contract services for military construction, research and development, and services funded for overseas contingency operations. Additionally, it provides for two adjustments to the limit above fiscal year 2010 budgeted levels. DOD may adjust spending above 2010 levels to account for (1) funding increases associated with contract services that were transferred from overseas contingency operations to the base budget and (2) the cost of additional civilian personnel positions over fiscal year 2010 levels.

The spending limit identified in the act applies to DOD in its entirety; therefore, individual components—military departments and defense agencies—may exceed their individual targets but DOD would still be in

compliance with the law if total obligations for contract services across the entire department were less than the aggregate limit.⁸ DOD identified an aggregate spending limit of \$55.75 billion for fiscal year 2014. Section 813 of the NDAA for fiscal year 2015 extended the aggregate spending limit through fiscal year 2015.⁹

Congress has also enacted legislation to improve the availability of information on DOD's acquisition of services and to help the department make more strategic decisions about the appropriate workforce mix of military, civilian, and contractor personnel. In fiscal year 2002, Congress enacted section 2330a of title 10 of the U.S. Code, which required the Secretary of Defense to establish a data collection system to provide management information on each purchase of services by a military department or defense agency.¹⁰ In 2008, Congress amended section 2330a of title 10 of the U.S. Code to require the Secretary of Defense to submit an annual inventory of contracted services performed for or on behalf of DOD during the preceding fiscal year.¹¹ This annual inventory submission is to include, among other things, the number of contractor full time equivalents and the associated direct labor cost for these positions.¹² More recently, section 955 of the NDAA for fiscal year 2013 required the Secretary of Defense to ensure that the civilian and service contractor workforces are appropriately sized to support and execute the National Military Strategy and to develop an efficiencies plan for those workforces.¹³ Section 955 further requires that the efficiencies plan ensures that total funding reductions for the civilian and service contractor workforces are commensurate with reductions in military end strength. We have on-going work assessing DOD's compliance with section 2330a

⁸The NDAA for Fiscal Year 2012 limited DOD's authority to obligate appropriated funds for services. For the purposes of this report, we use the term spending to refer to obligations.

⁹Pub. L. No. 113-291 § 813 (2014).

¹⁰The National Defense Authorization Act for Fiscal Year 2002, Pub. L. No. 107-107, § 801(c) (2001).

¹¹The National Defense Authorization Act for Fiscal Year 2008, Pub. L. No. 110-181, § 807.

¹²A full-time equivalent is a standard measure of labor that equates to 1 year of full-time work as defined by the page 6, section 20, Office of Management and Budget No. Circular A-11.

¹³Pub. L. No. 112-239 § 955 (2013).

as well as DOD's implementation of section 955 and plan to report the final results in fiscal year 2016.

Following the submission of the inventory, section 2330a(e) of title 10 of the U.S. Code requires the secretaries of the military departments and heads of the defense agencies to complete a review of the contracts identified in the inventory to ensure, among other things, that the activities do not include inherently governmental functions—which are those that require discretion in applying government authority—such as the determination of budget policy. The review should also ensure that to the maximum extent practicable, the activities do not include any closely associated with inherently governmental functions, which are those that may be at risk of becoming inherently governmental due to the manner in which the contractor performs the work, among other things. Upon completion of this review, DOD guidance instructs the secretaries of the military departments and heads of the defense agencies to submit an inventory review certification letter to the Office of Personnel and Readiness that outlines the results of the review and any corrective actions to be taken to ensure that contractors are not performing inherently governmental functions and to monitor the use of contractors for closely associated with inherently governmental functions.

Section 808 of the NDAA for fiscal year 2012 further reinforced those provisions by requiring DOD to issue guidance instructing components to reduce funding by 10 percent for fiscal years 2012 and 2013 for contracts identified with personnel performing closely associated with inherently governmental and staff augmentation functions. These functions may include personal services or other positions that may put the government at risk of contractors inappropriately influencing government decisions. Unlike the aggregate DOD spending limit, the statutory requirement for guidance on reductions in funding for closely associated with inherently governmental functions and staff augmentation are directed to each component; therefore, the reductions are expected to take place at each component, rather than an aggregate reduction across the department. Through subsequent revisions of the law, Congress extended the time period for DOD to implement the full 20 percent reduction for both closely associated with inherently governmental and staff augmentation functions through fiscal year 2015.¹⁴ Fiscal years 2014 and 2015 are also referred

¹⁴Pub. L. No. 113-291 § 813(c)(3) (2014).

to as carryover years—meaning that whatever required reductions that DOD did not achieve in fiscal years 2012 and 2013 are required to be taken in 2014 or 2015.

Prior GAO Work

In December 2014, we reported on DOD's implementation of the section 808 limitations in fiscal years 2012 and 2013.¹⁵ Specifically, we found DOD exceeded the spending limit in fiscal year 2012 and adhered to the limit in fiscal year 2013. However, we also identified issues with the DOD Comptroller office's calculation of the spending limit which resulted in an overstated limit in fiscal years 2012 and 2013. For example, in both fiscal years 2012 and 2013, the Comptroller included approximately \$248 million in research and development budgeted amounts in the spending limit, despite the law excluding such services from the spending limit. In addition, the Comptroller office's calculation of the civilian workforce adjustment was not consistently applied, further overstating the limit. As a result, we recommended that the Comptroller's office update its methodology to determine compliance with aggregate spending limit to correct these errors. DOD concurred with this recommendation and has taken steps to address it for fiscal year 2015, as discussed later in this report. After adjusting for these errors, we found that DOD obligated \$1.72 billion more than the limit in fiscal year 2012 and about \$500 million less than the limit in fiscal year 2013.

In our December 2014 report, we also found that each of the military departments exceeded their respective Comptroller-provided targets in fiscal year 2012. The departments implemented fiscal controls in fiscal year 2013, to varying degrees, which helped the Air Force and Navy adhere to their targets. However, the Army still exceeded its target by more than \$2 billion in fiscal year 2013. We concluded that significant discrepancies between the military departments' adherence to obligation targets for fiscal year 2013 signaled that improvements could be made to better manage contract services obligations and recommended that the Secretary of Defense evaluate the fiscal controls used by the military departments to identify effective practices to improve the management of contract services.¹⁶ DOD agreed with this recommendation and while the Comptroller's office has not taken action to implement it, the military

¹⁵ [GAO-15-115](#).

¹⁶ [GAO-15-115](#).

departments have improved implementation of fiscal controls as discussed later in this report. We also have ongoing work that will further examine DOD's planning, programming and budgeting process for contracted services and plan to report the final results in 2016.

We also found that DOD lacked the data necessary to determine if it implemented the required funding reductions for contracts with closely associated with inherently governmental and staff augmentation functions. Specifically, DOD issued guidance in June 2012 instructing components to rely on the inventory of contracted services to measure funding reductions for contracts with closely associated with inherently governmental functions.¹⁷ However, we found that the components' annual inventory reviews did not include information necessary to measure a funding reduction in these functions, such as comparable obligation data. Further, we found that the guidance lacked clarity in how reductions in staff augmentation funding should be implemented and measured. The guidance noted that these funding reductions were factored into budget requests for fiscal years 2012 and 2013, but did not specify the amounts of these budgeted reductions or the data source that should be used to determine if the reduction was achieved.

DOD updated its inventory guidance in May 2014, instructing components to identify the steps taken—supported with appropriate documentation—to demonstrate compliance with the required reductions. However, we found that the supplemental guidance did not provide components with any additional clarification in how to measure the reductions given the lack of data collected through past inventories. We also found that one measure that could be used to determine compliance was the advisory and assistance services budget category which includes many of the types of contractor services that are considered closely associated with inherently governmental and staff augmentation functions. As a result, we recommended that DOD identify additional data sources beyond the inventory of contracted services to help ensure that funding reductions called for in the law are implemented. DOD concurred with our recommendation. Moreover, section 813 of the NDAA for fiscal year 2015 facilitated DOD's implementation of our recommendation, encouraging DOD to use other data sources, such as advisory and assistance

¹⁷ Memorandum from the Deputy Secretary of Defense to Secretaries of the Military Departments and Heads of Defense Agencies, Subject: Guidance for Limitation on Aggregate Annual Amount Available for Contracted Services, June 3, 2012.

services, to measure compliance with closely associated with inherently governmental and staff augmentation funding reductions.¹⁸ Similarly, in April 2015, the DOD Inspector General found that the information included in the inventory was not sufficient to determine whether funding reductions were met and also recommended that DOD clarify how reductions should be reported.¹⁹

DOD Adhered to the 2014 Contract Services Spending Limit Due in Part to Increased Oversight from the Comptroller and Military Departments

DOD obligated \$54.6 billion, or \$280 million less than the limit on contract services in fiscal year 2014. In addition, the Comptroller's office improved planning and oversight of contract services for fiscal year 2014 by seeking input when setting spending targets and implementing a waiver request process to allow for adjustments during the year. These steps helped ensure that DOD adhered to the aggregate limit; but adherence to spending targets varied by the military departments. While, the Army and Navy exceeded the Comptroller-provided targets due, in part, to a lack of accurate budget and obligation data for contract services, the Air Force did not. However, Army and Navy budget officials identified additional steps they plan to take to better manage the contract services spending limit in the future.

DOD Adhered to the Spending Limit in Fiscal Year 2014 and Has Actions Underway to More Accurately Calculate the Limit in the Future

DOD adhered to the contract services spending limit for fiscal year 2014, obligating \$54.6 billion for contract services. DOD reported obligating \$1.17 billion less than the limit; however, consistent with our December 2014 report,²⁰ DOD's methodology for calculating the spending limit for fiscal year 2014 contained errors which caused it to overstate the limit. After adjusting for these errors in the Comptroller's methodology for calculating the limit, we estimated that DOD obligated \$280 million less than the limit on contract services in fiscal year 2014. In response to our December 2014 recommendations, the Comptroller took steps to correct its methodology for calculating the spending limit for fiscal year 2015, but

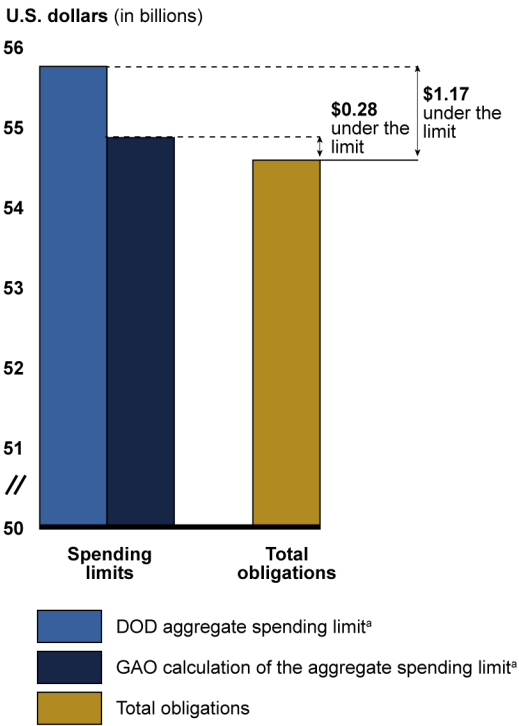
¹⁸The Carl Levin and Howard "Buck" McKeon National Defense Authorization Act for Fiscal Year 2015, Pub. L. No. 113-291, § 813(f) (2014).

¹⁹Inspector General, U.S. Department of Defense, April 15, 2015, Independent Auditor's Report on Agreed-Upon Procedures for DOD Compliance with Service Contract Inventory Compilation and Certification Requirements for Fiscal Year 2013, Report No. DODIG-2015-106.

²⁰[GAO-15-115](#).

these changes were not yet in place for fiscal year 2014 implementation. For example, the Comptroller's office again included \$248 million in research and development budgeted amounts in its spending limit baseline for fiscal year 2014. Further, we found that by again including civilian medical personnel in the civilian workforce adjustment, DOD overstated the spending limit by \$642 million for fiscal year 2014. Therefore, in total, the Comptroller's office overstated the spending limit by \$890 million in fiscal year 2014, whereas the actual limit should be reduced from \$55.8 billion to \$54.9 billion, as shown in figure 1.

Figure 1: Comparison of DOD and GAO Spending Limit Calculations for Fiscal Year 2014



Source: GAO analysis of DOD financial data. | GAO-15-780

^aBoth DOD and GAO calculations exclude contract services for medical care and other services from federal sources, as these categories have been excluded from the contract services spending limitation.

As a result of these errors in accounting for both research and development and the calculation of civilian workforce increases, DOD's obligations were \$280 million under the limit rather than the \$1.17 billion reported by DOD.

Comptroller Increased Oversight of Contract Services Spending for Fiscal Year 2014

The Comptroller's office took steps in fiscal year 2014 to improve management of the contract services spending limit.

- The Comptroller's office sought input from components when setting target amounts for fiscal year 2014. For example, a Comptroller official said the office obtained additional input from the Army to justify an increase in the Army's target rather than relying solely on the Army's budget request. In fiscal years 2012 and 2013, the Comptroller's office set targets for each component based on their respective budgeted amounts for contract services, but did not seek additional input from components on these targets.
- As part of DOD's fiscal year 2014 spending limit guidance, the Comptroller also implemented a waiver process allowing components to notify the Comptroller during the year if they expected to exceed their spending targets and request approval to exceed the target. Similar to fiscal years 2012 and 2013, the Comptroller's office set targets for fiscal year 2014 below the spending limit to allow for unexpected costs during the year. This new process allowed the Comptroller to approve adjustments related to specific requests and allocate portions of the reserved amount among the components. Through this process, the Comptroller received three waiver requests totaling \$607 million for fiscal year 2014. For example, the Navy submitted a waiver request in June 2014 requesting \$263 million in additional target allocation to account for additional costs, such as ship and facilities maintenance, ship modernization, and audit readiness.

These additional steps allowed the Comptroller to ensure that targets were achievable based on components' input and make adjustments to targets when needed during the year.

Military Departments Took Steps to Improve Fiscal Controls, but Varied in Adherence to Obligation Targets

For fiscal year 2014, the military departments continued to improve their management of contract services obligations, but experienced varied success in adhering to their targets. *Standards for Internal Control in the Federal Government* call for effective control activities that enforce guidance to help ensure stewardship of government resources.²¹ We found that the military departments used a variety of controls to manage contract services obligations to ensure compliance with the Comptroller-

²¹GAO, *Standards for Internal Control in the Federal Government*. [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

provided targets, with the Army improving its controls from previous years.

As shown in table 1, the military departments implemented controls such as soliciting contract services budget estimates from commands—an organizational sub-unit of a military department or defense agency—providing each command with individual contract services spending targets, or monitoring contract services obligations. Nevertheless, in fiscal year 2014, the Army and Navy exceeded their spending targets.

Table 1: Military Department Actions to Manage Contract Services in Fiscal Year 2014

Dollars in billions

Military Department	Solicited Commands' Input	Set Command Targets	Monitored Obligations	Obligations against target
Air Force	✓	✓	✓	\$1.45 under
Army	✓ ^a	✓	✓ ^a	\$0.25 over
Navy	✓		✓	\$1.07 over

Source: GAO analysis of information provided by DOD officials. | GAO-15-780

Note: Table does not include defense agencies, which collectively obligated \$1.02 billion less than the defense agency targets because these agencies were not included in the scope of our review. DOD set obligation targets for the military departments and defense agencies totaling \$55.73 billion based on its calculation of an overstated spending limit. DOD's corrected spending limit is \$54.86 billion or \$868 million less than the total target amount provided to the military departments and defense agencies.

^aNew control implemented in fiscal year 2014.

Air Force

The Air Force obligated \$1.45 billion less than its fiscal year 2014 target provided by the Comptroller. Similar to fiscal year 2013, the Air Force Financial Management and Comptroller (FMC) office provided each of its commands with a contract services obligation ceiling through their annual operations and maintenance funding letters.²² When determining ceiling amounts, FMC instructed each command to submit an execution plan for fiscal year 2014 that included a 10 percent reduction in contract services from their respective budget estimates. An FMC official said this amount was withheld to allow the Air Force to respond to potential Congressional

²²Funding letters are an administrative funds control mechanism used by the Air Force to sub-divide, or allot, its full appropriation among commands and to ensure that collective obligations by all commands do not exceed the total appropriation amount.

reductions and provided a margin for unexpected costs that may occur during the year. Throughout the year, FMC officials said the office monitored monthly obligations levels and communicated with commands to ensure that they adhered to their targets. Air Force officials said that FMC did not have to make adjustments to command's obligation targets for fiscal year 2014, as each command was able to manage to their respective target.

Army

In fiscal year 2014, the Army obligated \$254 million more than its adjusted Comptroller target. After exceeding its contract services targets by more than \$2 billion in both fiscal years 2012 and 2013, the Army took additional steps to manage and monitor the contract services spending limit for fiscal year 2014 and as a result came much closer to meeting its spending target. Army budget officials attributed a portion of the obligations over its target to coding errors in its financial system. These coding errors include obligations for contract services from overseas contingency operations that are not subject to the spending limit but were inadvertently included in the Army's submission to the Comptroller's office. Army budget officials attributed these errors to limitations with its financial system and said that they plan to review the fiscal year 2015 obligation data to correct these errors before submitting its data to the Comptroller's office.

One step taken by the Army Budget Office in fiscal year 2014 to better manage contract services was to solicit contract services estimates from commands outside of the regular budgeting process. An Army budget official explained that this step was needed because in fiscal years 2012 and 2013 the Comptroller set the Army's spending target based solely on its enacted budget amounts for contract services. However, Army budget officials explained that these budget estimates did not accurately capture the extent to which funds were allocated to contract services because Army commands do not separately identify contract services budget estimates in their annual budget inputs to the Army Budget Office for inclusion in the President's budget. Instead, the Army budget office relies on historical budget data to determine contract services budget estimates for inclusion in the budget request and as a result had underestimated the level of obligations allocated for contracted services. For example, in fiscal year 2013, the Army obligated \$2.7 billion more than estimated for

contract services.²³ An Army budget official said that based on the Army command inputs, the Army Budget Office was able to develop a more realistic contract services spending estimate to use in negotiations with the Comptroller's office. Based on this information, the Comptroller agreed to increase the Army's target by \$1.7 billion over its 2013 level.

While this represented an increase over previous years, Army budget officials said that the increased target still left the Army with a shortfall to manage. For example, the Army had already provided spending targets to its commands totaling \$11.2 billion for contract services in the operations and maintenance account for fiscal year 2014, but was provided a target of \$10.1 billion for this account by the Comptroller in May 2014. To address this issue, an Army budget official said they monitored contract services obligations during the year and once they received the Comptroller's target, further worked with commands to reduce contract services obligations in line with the lower target. By doing so, the Army obligated \$10.4 billion on contract services for the operations and maintenance account, or \$800 million less than the initial spending targets provided to commands. Further, the monitoring allowed Army budget officials to identify, request, and obtain approval for an additional \$200 million from the Comptroller.

Navy

In fiscal year 2014, the Navy obligated \$1.07 billion more than its adjusted Comptroller target. Similar to fiscal year 2013, Navy FMC officials said they do not set command spending targets for contract services, but expect commands to stay within their respective budgeted amounts for contract services. Additionally, FMC officials reviewed execution levels against budgeted amounts during their mid-year execution review. Based on the obligation information available through the mid-year review, the Navy submitted a waiver request to the Comptroller's office in June 2014 requesting an additional \$263 million in target allocation due, in part, to additional ship maintenance costs, which was approved by the Comptroller's office.

Despite the increase in the Navy's target amount, Navy FMC officials identified two factors that led to the Navy exceeding its target. First, when conducting the end of year financial review in September 2014, the Navy

²³These obligations and budgeted amounts exclude certain categories of contract services, such as research and development, military construction, medical care and services from other federal sources.

FMC office identified an additional \$400 million in contract services needed for unanticipated costs, but did not submit a waiver request to the Comptroller since the fiscal year was ending. To mitigate this issue for fiscal year 2015, the Navy FMC office began monthly monitoring of contract services obligations, which should help identify potential overages as they occur instead of only at the mid-year and end-of-year execution reviews and allow more time to make adjustments when necessary.

Second, Navy FMC officials attributed the remaining \$600 million of the \$1.07 billion it obligated over its target to a coding error in its financial system. Specifically, Navy FMC officials said the financial system does not allow for coding of progress payments on items, such as ships or aircraft. To make progress payments for these types of items, Navy FMC officials explained that these payments are coded as contract services to work around the system limitation. Navy financial management officials said they manually corrected these coding errors in the past, but decided to forego the manual corrections in fiscal year 2014 in preparation for audit readiness in fiscal year 2016. The Navy FMC office requested updates to its financial system in August 2013 to correct this coding issue, but the change has not yet been approved or implemented.

Military Departments Achieved Required Funding Reduction for Key Functions Based on Revised Approach to Measure Compliance

Our analysis of DOD obligation data indicate that all of the military departments achieved funding reductions greater than 20 percent for closely associated with inherently governmental and staff augmentation functions by fiscal year 2014. Section 813 of the NDAA for fiscal year 2015 facilitated DOD's implementation of our December 2014 recommendation by encouraging DOD to use different data sources, such as advisory and assistance services, to measure compliance with closely associated with inherently governmental and staff augmentation funding reductions. Advisory and assistance service is a budget category that includes many of the types of contractor services that are considered closely associated with inherently governmental and staff augmentation functions. As we reported in December 2014, the advisory and assistance services budget category is not an exact measurement of closely associated with inherently governmental and staff augmentation functions. However, it may be the best currently available data source to determine reductions in these functions. This new measure was adopted after a lack of data hindered DOD's previous attempts to demonstrate compliance. Specifically, previous attempts to use the inventory of contract services showed that it did not provide the data necessary to measure the reductions. For example, DOD instructed components to report on actions taken to implement reductions through the fiscal year

2013 inventory review, but only one of 35 components reported all of the information necessary to demonstrate compliance.

In May 2015, the Comptroller issued guidance instructing components to submit a separate budget exhibit for the fiscal year 2017 budget submission with advisory and assistance service obligations for fiscal years 2010 through 2015 to demonstrate the required funding reductions in closely associated with inherently governmental and staff augmentation contracts. While these data have not yet been reported through fiscal year 2015, our analysis of currently available obligation data for advisory and assistance services indicate that all of the military departments achieved reductions of greater than 20 percent by fiscal year 2014. As shown in table 2, the Air Force and Navy achieved reductions in advisory and assistance service obligations greater than 30 percent from fiscal years 2010 through 2013. The Army achieved a 9 percent reduction by fiscal year 2013, but achieved a 32 percent reduction in fiscal year 2014.

Table 2: DOD Military Department Advisory and Assistance Obligation Reductions, Fiscal Years 2010-2014

Military Department	Percent Reduction, 2010-2013	Carryover reduction needed in 2014?	Percent Reduction, 2010-2014	Carryover reduction needed in 2015?
Air Force	32	No	NA	No
Army	9	Yes	32	No
Navy	35	No	NA	No

Source: GAO analysis of DOD Obligation Data. | GAO-15-780

Note: Data exclude advisory and assistance service obligations for research and development, military construction or overseas contingency operations in accordance with section 808 of the National Defense Authorization Act of fiscal year 2012.

The DOD Comptroller intends to measure a 30 percent reduction from 2010 levels based on former Secretary of Defense Robert Gates' Efficiencies Initiative which called for DOD to reduce service support contractors by 10 percent each year from fiscal year 2011 through 2013, for a total 30 percent reduction.²⁴ While section 808 calls for a total of 20 percent in reductions in fiscal years 2012 and 2013, a Comptroller official

²⁴Secretary Gates announced the Efficiencies Initiative in August 2010 that directed, among other things, a reduction of funding for support contractors by 10 percent a year for each of the next three years. DOD News Release No: 706-10, August 9, 2010.

said it plans to also include the additional 10 percent reduction for fiscal year 2011 called for by Secretary Gates' Efficiencies Initiative. If components are not in compliance with the full 30 percent reduction by fiscal year 2015, a Comptroller official said that the Comptroller's office plans to enforce the reduction by making adjustments to component funding levels for the fiscal year 2017 budget submissions.

As indicated by the Comptroller's May 2015 guidance, the office plans to assess the military departments and defense agencies reductions in advisory and assistance service obligations when the fiscal year 2017 budget is submitted. Therefore, compliance with the required funding reductions will not be determined by the Comptroller's office until early fiscal year 2016 when DOD has complete data on each component's fiscal year 2015 obligations. However, a Comptroller official agreed that the data as presented in table 2 are consistent with its preliminary analysis indicating that each of the military departments has met the full 20 percent reduction.

Agency Comments

Because DOD has efforts underway to address our December 2014 recommendations, we are not making new recommendations in this report.²⁵ We provided a draft of this report to the Secretary of Defense for review and comment. In DOD's written comments, reproduced in appendix II, the Director for Operations, Office of the Under Secretary of Defense (Comptroller), concurred with the findings of our report.

²⁵[GAO-15-115](#).

We are sending copies of this report to the appropriate congressional committees, the Secretary of Defense, and the Under Secretary of Defense (Comptroller). In addition the report is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-4841 or makm@gao.gov. Contact points for our Office of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix III.

A handwritten signature in black ink, appearing to read 'Marie A. Mak', with a stylized, flowing script.

Marie A. Mak
Director, Acquisition and Sourcing Management

List of Committees

The Honorable John McCain
Chairman
The Honorable Jack Reed
Ranking Member
Committee on Armed Services
United States Senate

The Honorable Thad Cochran
Chairman
The Honorable Richard J. Durbin
Ranking Member
Subcommittee on Defense
Committee on Appropriations
United States Senate

The Honorable Mac Thornberry
Chairman
The Honorable Adam Smith
Ranking Member
Committee on Armed Services
House of Representatives

The Honorable Rodney Frelinghuysen
Chairman
The Honorable Pete Visclosky
Ranking Member
Subcommittee on Defense
Committee on Appropriations
House of Representatives

Appendix I: Objectives, Scope, and Methodology

The objectives for this review were to determine the extent to which the Department of Defense (DOD) implemented the requirements of section 808 of the National Defense Authorization Act (NDAA) for fiscal year 2012, as modified by section 802 of the NDAA for fiscal year 2014. Specifically, we assessed DOD's implementation of the 1) contract services spending limit for fiscal year 2014 and 2) funding reductions for contracts with closely associated with inherently governmental and staff augmentation functions from fiscal years 2010 through 2014.

To determine the extent to which DOD implemented the contract services spending limit in fiscal years 2014, we reviewed relevant laws and DOD guidance, analyzed budget and obligation data from the Office of the Under Secretary of Defense Comptroller for fiscal years 2010 and 2014 from the program resource collection process (PRCP) system, and interviewed DOD and military department budget officials. Specifically, we reviewed DOD's fiscal year 2014 section 802 guidance, issued in May 2014, to determine steps taken by the Comptroller's office to implement the limit. Further, we reviewed the Comptroller's methodology for calculating the spending limit by analyzing the categories of services DOD included in the spending limit baseline. We then compared these categories to the fiscal year 2014 obligation data DOD used to determine its compliance with the spending limit to ensure that both the baseline and obligation data included consistent categories of contract services. To ensure that contract services obligation data from PRCP were sufficiently reliable to determine compliance with the spending limit, we compared the PRCP obligation data to contract services obligations reported in the Federal Procurement Data System-Next Generation from fiscal years 2010 through 2014 and found that both sources showed a similar downward trend in contract services obligations.¹ Further, we compared the PRCP obligation data to military department contract services obligations reported in their respective financial systems to identify any obvious errors or differences. When differences were identified, we interviewed knowledgeable budget and financial management officials from the military departments' and Comptroller's office to determine the reasons for these differences. Based on these steps, we determined that the Comptroller's PRCP obligation data were sufficiently reliable for our purposes. To identify steps taken by the DOD to implement fiscal

¹The Federal Procurement Data System-Next Generation is the primary government-wide contracting database that provides information on all government contracting actions.

controls, we limited our analysis to implementation efforts by the military departments, which account for over 70 percent of DOD's contract services obligations in fiscal year 2014. To identify the steps taken by each military department to implement controls over contract services obligations, we interviewed military department budget and financial management officials and reviewed available guidance issued by each of military department to implement the spending limit.

To assess the extent to which DOD components reduced funding for contracts containing closely associated with inherently governmental and staff augmentation functions from fiscal years 2010 through 2014 we reviewed section 802 implementation guidance issued by the Comptroller's office, which instructed components to follow additional guidance. The additional guidance issued by the Office of the Assistant Secretary of Defense for Readiness and Force Management in May 2014 instructed each component to report in their fiscal year 2013 inventory review certification letters specific actions taken and supporting documentation to demonstrate compliance with the required 10 percent funding reduction for closely associated with inherently governmental and staff augmentation contracts in fiscal years 2012 and 2013. We analyzed certification letters submitted by 35 DOD components for the fiscal year 2013 inventory review to determine what steps and supporting documentation each component provided to demonstrate compliance with the required funding reductions for closely associated with inherently governmental functions and staff augmentation contracts. In addition, we interviewed officials responsible for compiling and reviewing the inventory of contracted services to gain additional insight into the steps taken to implement the reductions. Based on updated guidance from the Comptroller, issued in May 2015, instructing components to rely on the advisory and assistance services budget category to measure the reductions, we analyzed each military department's obligations for this budget category reported in the Comptroller's PRCP data from fiscal years 2010 through 2014 to determine if reductions had been achieved by the military departments.

We conducted this performance audit from January 2015 through September 2015 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Comments from the Department of Defense



COMPTROLLER

UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

(Program/Budget)

SEP 16 2015

Mr. Marie A. Mak
Director, Acquisition and Sourcing Management
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Mak:

This is the Department of Defense (DoD) response to the Government Accountability Office (GAO) Draft Report GAO-15-780 "DOD CONTRACT SERVICES: Improvements Made to Planning and Implementation of Fiscal Controls," dated August 17, 2015. The Department appreciates the GAO's work on this engagement, as well as the opportunity to review and comment on this draft report.

The Department of Defense concurs with the draft report and has no comments.

Sincerely,

Monique Dilworth
Director for Operations



Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Marie A. Mak (202) 512-4841 or makm@gao.gov

Staff Acknowledgments

In addition to the contact named above, W. William Russell (Assistant Director); Beth Reed Fritts; and Suzanne Sterling made significant contributions to this review. In addition, Pete Anderson, Virginia Chanley, John Krump, and Roxanna Sun made key contributions to this report.

GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's website (<http://www.gao.gov>). Each weekday afternoon, GAO posts on its website newly released reports, testimony, and correspondence. To have GAO e-mail you a list of newly posted products, go to <http://www.gao.gov> and select "E-mail Updates."

Order by Phone

The price of each GAO publication reflects GAO's actual cost of production and distribution and depends on the number of pages in the publication and whether the publication is printed in color or black and white. Pricing and ordering information is posted on GAO's website, <http://www.gao.gov/ordering.htm>.

Place orders by calling (202) 512-6000, toll free (866) 801-7077, or TDD (202) 512-2537.

Orders may be paid for using American Express, Discover Card, MasterCard, Visa, check, or money order. Call for additional information.

Connect with GAO

Connect with GAO on [Facebook](#), [Flickr](#), [Twitter](#), and [YouTube](#).
Subscribe to our [RSS Feeds](#) or [E-mail Updates](#).
Listen to our [Podcasts](#) and read [The Watchblog](#).
Visit GAO on the web at www.gao.gov.

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Website: <http://www.gao.gov/fraudnet/fraudnet.htm>

E-mail: fraudnet@gao.gov

Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Katherine Siggerud, Managing Director, siggerudk@gao.gov, (202) 512-4400, U.S. Government Accountability Office, 441 G Street NW, Room 7125, Washington, DC 20548

Public Affairs

Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800, U.S. Government Accountability Office, 441 G Street NW, Room 7149, Washington, DC 20548



Please Print on Recycled Paper.